Proskauer

Best Practice – The FCA's Review of Liquidity Management in Funds

11 July, 2023

Background

On 6 June 2023, the UK's Financial Conduct Authority ("**FCA**") published the findings of its review of liquidity management in asset managers (the "**Review**"). The FCA also published an accompanying "Dear CEO" letter (the "**Letter**").

The Review follows a letter that was sent to the Boards of Authorised Fund Managers ("**AFMs**") in November 2019, detailing good practice in liquidity management. The Review allowed the FCA to see what improvements have been made since 2019 and what weaknesses remain.

Applicability

The FCA has stated that, although the Review mainly focussed on AFMs, it expects all asset managers to consider the findings for their business too.

Findings

The FCA's key findings were as follows:

- **Coherent frameworks:** Although the building blocks and tools for effective liquidity management were usually in place at firms, these lacked coherence when viewed as a full process and were not always embedded into daily activities.
- **Appropriate prioritisation:** Many firms attach insufficient weight to liquidity risk management in their governance oversight arrangements, as well as insufficient challenge and escalation, particularly in volatile environments.
- **Varying methodologies:** The FCA saw a wide range of approaches to liquidity stress testing, with some methodologies insufficient to assess actual liquidity of the portfolio, using assumptions that were not appropriately conservative. For example, some firms' models assumed that they would always sell the most liquid assets, without ever giving regard to the liquidity of selling a 'vertical slice' of the portfolio.
- **Redemption arrangements:** Firms typically had governance and organisational arrangements in place to meet large one-off redemptions, but did not have

sufficient arrangements in place to oversee cumulative or market-wide redemptions that could have a significant impact on a fund.

- **Applicability of tools:** There were wide variations in the application of anti-dilution tools such as swing pricing, which could affect the price investors receive when redeeming.

Next steps

Although there are no new, binding regulatory obligations, the FCA has stated that it expects firms to review their liquidity management arrangements, consider the application of the Review's findings and the Letter, and make any enhancements that may be necessary.

The FCA also expects firms to take note of the good practices highlighted in the Review, with the aim to improve consumer outcomes, particularly in light of the Consumer Duty which comes into force on 31 July 2023.

For further information, please reach out to UKRegulatory@proskauer.com.

Related Professionals

- **John Verwey**
  Partner
- **Sulaiman I. Malik**
  Associate
- **Michael Singh**
  Associate